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GOVERNOR TED SCHWINDEN
Capitol Building
Helena, Montana 59620

Dear Governor Schwinden,

I am submitting this minority report of the Economic Transition Task Force as an alternative approach for your consideration.

I assure you that I was given every opportunity to fully participate in the discussions of the Task Force. My exceptions to the Task Force report have to do with (1) the structure of the report in recommending actions, (2) the overall tone, attitude and approach, (3) the substance of the recommendations.

Specifically, my report differs from the Task Force report in that I:

- emphasize the importance of local efforts in economic growth;
- focus attention on small communities and rural areas, which otherwise receive only marginal benefits from attention on large corporations;
- emphasize generation of Montana capital, rather than luring out-of-state investment;
- emphasize growth and formation of numerous independent small businesses;

I have tried to use available reliable data to draw conclusions regarding the real opportunities for leveraging statewide growth; Also, I have considered the admonitions of David Birch -- that we avoid the traditional warfare, and that we focus on the sectors of Montana economy that can potentially stimulate growth.

My minority report recognizes the importance of agriculture to this state, not as a potential growth industry, but as the anchor that supports 90% of the communities in this state, and the need to stabilize the vitality of that industry. The Task Force report stresses the need to actively help those communities in economic development efforts.

The Task Force report, in recommending elimination of the unitary tax method, advocating branch and interstate banking, and recommending a statewide sales tax, gives preferential advantage to large national and foreign corporations over Montana and agricultural-oriented firms.

Please accept my minority report in the positive way it is intended -- as an alternative approach to that of the Task Force. My intention is to outline a true strategy for economic growth, one that will allow for Montana's continued independence, feature our state's strengths, and address the constraints we bear.

Sincerely,

JIM E. RICHARD

INTRODUCTION

The following is presented as a minority report of the Governor's Economic Transition Task Force. This minority report attempts to systematically develop a strategy for fostering economic growth in Montana through a process of using information an data presented by a variety of sources. From that information and a statement of goals and policies, specific measures for generating economic growth in Montana surfaced.

This minority report tries to heed the advice of Dr. David Birch, the man whose ideas and comments triggered the Economic Transition Task force in the first place, by:

- focusing on those sectors of Montana's economy that have potential for significant statewide growth;
- avoiding the old civil warfare in Montana that comes with proposing breaks for business and resource-based industry in taxation and regulation.

This minority report differs from the report of the Task force by:

- placing particular emphasis on technical and financial assistance to local economic development efforts;
- urging attention on the agricultural industry,and the dependent rural communities;
- not recommending changing or eliminating the unitary tax accounting method, unless careful study is made of the impact on Montana businesses;
- not recommending branch banking, bank mergers and interstate banking;
- continuing the "window of opportunity" break on the coal severance tax, rather than lowering the coal severance rate to a level near that of Wyoming;
- not recommending a sales tax, except as part of local option taxes that local units of government could select to reduce local reliance on property taxes.

This minority report, for sake of time and space, does not dwell on the positive contributions of state government, but recognizes the actions and programs of the Governor, Legislature and state agencies that are being implemented.

In fact, the Department of Commerce assistance, the "Build Montana" programs, the personal discussions of the Governor with each prospective firm, and the recent Legislative business tax relief are all testimony to the pro-business efforts of state government.

The minority report recommends an active, aggressive approach to economic development. Hard work, active promotion, constant nurturing, (especially at the local level) will result in new employment. The state's role will be to actively assist local development efforts and individual firms in their location or expansion plans. While continual re-examination of state laws and regulations is always necessary, this report does not assume that lowering business taxes and reducing regulations will let us sit back and watch business grow or move in.

The minority report agrees with the Task force report in a number of areas:

- bolstering the state's higher education system to produce more applied research, more innovative technology;
- reforming our tort and liability laws, and workers compensation provisions.

We need to conduct honest studies of other western or rural states' experience with the perennial proposals to improve Montana's business climate. We probably could stop guessing at the effects on economic development that would result from adoption of branch banking, replacing a property tax with a sales tax, and eliminating unitary tax accounting by observing the results in other states.

Finally, Montana's image is probably affected as much by the conduct of our existing industries and business as any single factor. Our most influential advertising, positive or negative, is by the firms that are doing business in Montana.

SUMMARY

GOALS OF ECONOMIC DEVELOPMENT

1. Increase the number of stable, long term jobs in Montana.
2. Increase the level of total personal income.
3. Expand the tax base, both for property and income-based taxes.

POLICIES

1. The state will encourage growth in all sectors of the private economy, but will aggressively promote growth in those sectors that are most likely to produce higher levels of growth and economic stability.
2. The state will promote economic development in all areas of Montana, both rural and urban.
3. To encourage economic stability, the state will promote a diversity of industries and industry types.
4. To encourage economic stability, The state will promote an economic structure comprising a diversity of numerous owners and entrepreneurs, especially Montana-owned businesses.
5. New growth should pay its way fiscally (i.e., local taxpayers are not expected to subsidize economic growth).
6. New growth should be compatible with other state taxation, environmental and social goals and policies.

BASIC ELEMENTS OF A STATE ECONOMIC DEVELOPMENT STRATEGY

1. Promote further processing ("value added") of Montana products.

2. Promote a positive climate and provide technical and financial assistance for local economic development efforts.

3. Expand out-of-state and foreign markets for Montana products, and expand out-of-state travel to Montana.

4. Stabilize the agricultural industry to serve as the anchor for the state's economy but especially for rural areas.

5. Develop stronger higher education programs oriented toward applied research and entrepreneurship, and increased training and retraining programs for workers.
6. Increase the availability of capital and other business financing.

7. Reform Montana's laws regarding liability and tort, workers compensation, and securities. Continue the "window of opportunity" on the coal severance tax.

8. Prepare a long range natural resources plan that addresses the appropriate level of production, future markets, future supplies, and regulatory or taxation requirements that hinder growth.

EXPLANATION

GOALS OF ECONOMIC DEVELOPMENT

The following three goals of economic development may seem self-evident, but it is probably useful to express them at the outset to ensure that everyone agrees on the overall purpose and goals of a state economic development strategy.

1. Increase the number of stable, long term jobs in Montana.

An increase in employment of any kind and of any duration is beneficial, but the goal of a state level economic development effort should be placed on long term jobs. The state economy and the economies of local communities are more stable where employment has some degree of durability (e.g., a handful of new jobs in a locale for a summer is not economic development).

2. Increase the level of total personal income.

While jobs may seem to be the number one objective of economic development, it is really the increase in income through increased sales and wages that provides the money to pay for more jobs. Both increasing the flow of outside dollars into Montana and reducing the flow of dollars out of the state allows more money to circulate within the state, thereby increasing the number of jobs.

3. Expand the tax base, both for property and income taxes.

Broadening the tax base will benefit all existing Montana taxpayers. Increased industrial and business development will help local governments and the local taxpayers who support those units of government through property taxes, and will help state government and the taxpayers who support it through a variety of income-based taxes.

Remembering the importance of tax base expansion may be helpful as the state develops an economic development strategy.

POLICIES

1. The state will encourage growth in all sectors of the private economy, and will aggressively promote growth in those sectors that hold the most promise for higher levels of growth and economic stability.

Under this policy, growth in all private economic sectors will be encouraged. However, a number of sectors provide a high percentage of the employment in Montana or offer the potential for high levels of growth, and those sectors should be given high priority in a state economic development program.

Growth in some sectors is limited primarily by factors outside of Montana's influence (i.e., limited raw materials or resources, national or international markets or policies), and the state should assist these sectors within the limits of its influence, but not devote an excessive amount of time, money and effort.

2. The state will promote economic development in all areas of Montana, both rural and urban.

Although a majority of Montanans live in urban areas, most of the state's local communities are rural. A state economic development strategy should promote economic growth in rural communities as well as urban areas. Because of their dependence on agriculture, rural communities will benefit from a strong agricultural economy and formation or location of firms that process agricultural products.

Also, an infusion of non-agricultural industry benefits rural communities by diversifying their economies and relieving their strict dependence on agriculture. State government should focus attention on the dozens of local rural jurisdictions that are working to stimulate economic growth.

3. To encourage economic stability, the state will promote a diversity of industries and industry types.

An economy, state or local, that comprises many different types of industries is healthier and more stable than an economy that relies on one or two dominant industries. During times when one economic sector may be suffering, a diversified economy can be "carried" by the other healthy sectors.

4. To encourage economic stability, The state will promote an economic structure comprising numerous independent owners and entrepreneurs, especially Montana-owned businesses.

Just as an economy comprising a diversity of industries and different types of industries is healthy and more stable, an economy composed of many independent small firms is more stable than one dominated by one or two large companies. When one large corporation decides to reduce or eliminate its operation in a community, the effects of the layoffs usually are dramatic and sudden (however, a large corporation can have dramatic positive effects on a community when it decides to expand). Where an economy has many smaller firms, a few firms can experience problems and even go out of business, but the overall economy stays healthy because the other firms continue to do well.

A high percentage of the profits and savings by Montana-based firms are invested or reinvested in Montana, whereas national corporations necessarily must send much of its Montana-derived income to out-of-state investments or stockholders. To the extent that small Montana-based firms keep their earnings in

the state each dollar they earn generates more secondary economic growth than that of large corporations.

Large national corporations usually make decisions about their Montana operations in out-of-state headquarters, based on the economic welfare of the corporation.

Small Montana-based firms have a stronger commitment to doing business in Montana and are more willing to "tough out the hard times" and stay in business here.

We recognize that growth of any new businesses and industry, large or small, is good for the economy of the state. However, growth composed of numerous small firms has certain advantages over growth dominated by large corporations.

The policy of Montana, therefore, is to encourage location of large corporations in the state, but to aggressively promote the formation or location of small firms, especially Montana-based firms.

5. New growth should pay its way fiscally (i.e., local taxpayers are not expected to subsidize economic growth).

Economic growth should pay its way by providing additional tax revenues sufficient to pay the costs of increased services generated by the firm and any associated in-migrating population. Local taxpayers should not be expected to subsidize new economic growth by having to pay higher taxes for additional local services.

6. New growth should be compatible with other state taxation, environmental and social objectives.

A state economic development strategy must recognize that Montana has enacted a number of requirements that serve revenue, environmental or certain social purposes. Usually, those requirements were enacted after much struggle, often bitter disagreement. Many requirements remain after having been challenged one or more times in the legislature.

While some of the requirements may have been passed to frustrate industry or growth, most were enacted to achieve some legitimate purpose. They are in place, not by accident, but after long and open public debate. Any changes in the state's taxation or regulatory requirements should be made only after careful consideration of the effects of those changes on the general public.

BASIC ELEMENTS OF A STATE ECONOMIC DEVELOPMENT STRATEGY

1. Promote further processing ("value added") of Montana products.

- Departments of Commerce and Agriculture take the lead in coordinating state agency and University research re: new products, new markets, feasibility studies and economics of processing Montana raw materials -- meat, grain, metals, coal, petroleum, timber;
- provide technical assistance in marketing, packaging, merchandising Montana value-added products;
- provide tax incentives, and specific financing programs for value-added processing;

2. Provide assistance, and promote a positive climate, for local economic development efforts.

- allow local tax options, with voter approval, for economic development and rehabilitation and management of public services;
- provide state financial assistance in repair, rehabilitation, maintenance, planning, and management of local infrastructure by securing bonding from ear-marked earnings from the Coal Trust Fund;
- provide financial assistance, through the Department of Commerce, to local development organizations for economic development planning, management, etc.
- enable the Department of commerce to offer more workshops, conferences and other technical assistance for local people on economic development, taxation, marketing, private financing;
- expand the application of tax-increment financing by deleting the restriction to urban renewal areas, or allow tax-increment financing for industrial/commercial areas;

3. Expand promotional efforts for Montana: out-of-state and foreign markets for Montana products, out-of-state travel to Montana, and public relations and information campaign regarding Montana's business assets and climate.

- encourage the establishment of a number of mail order businesses that feature Montana products; assist with advertising and market research;
- establish outlets in New York (Minneapolis?) and other metropolitan areas to sell Montana products and promote travel to Montana; these outlets would tie into the in-state mail order businesses;
- support an expanded international trade marketing effort in coordination with private organizations;
- participate in national expositions and trade shows to expand markets in Seattle, Denver, Minneapolis, and other major trade areas;

• increase funding of state tourist promotion through a 4% accommodations tax; of those revenues 1/4 would be returned to local communities, 3/4 ear-marked to the state for travel promotion;

• deregulate motorcoach industry;

• improve and stabilize airline service to Montana;

• establish limits and ranges on liability awards;

• provide financial and technical assistance for travel-related enterprises (e.g., motorcoach tours);

• conduct a national public relations and advertising campaign to inform people of Montana's business assets and correct misconceptions about our business climate.

4. Stabilize the agricultural industry to serve as the anchor for the state's economy, especially for rural areas.

• reorient University System research from production technology to market research, new products,

• promote processing of agricultural products in rural communities;

• reorient the Extension Service and University curriculum toward agricultural management, marketing, entrepreneurship;

• fully utilize the linked deposit farm loan program;

• Departments of Agriculture and Commerce assist with marketing of agricultural and other products;

• Department of Commerce emphasizes local assistance to rural communities in actively promoting formation or location of value-added processing firms or non-agricultural industry in rural communities;

5. Develop stronger higher education programs oriented toward applied research and entrepreneurship, and increased training and retraining programs for workers.

• expand and revise Montana's existing University research facilities toward applied research and technology, product and market development; The research and studies would focus on new and expanded markets, feasibility studies, new products and technologies using Montana resources and products, innovations in value added processing Montana products and raw materials; Applied research centers would be established at Montana State University to serve the agriculture industry; at the University of Montana to serve the timber industry; and at Montana Tech to serve the mineral extraction industries;

• the University degrees in agriculture, forestry, mining and business should place more emphasis on business management, marketing, feasibility analysis, financial management and stimulating entrepreneurship;

• strengthen the state's programs in on-the-job training, re-training for skills in new technologies; vocational training;

• provide hospitality training for managers, and employees of firms that serve the traveling public;

6. Increase the availability of capital and other business financing.

- increase the tax credit for venture capital companies from 25% to 50% to stimulate investment in venture capital;
- authorize the Board of Investments to place a limited amount of assets ($10-20 million) in a venture capital fund;
- expand support for Montana Science and Technology Alliance $7-8 million for the biennium;
- expand Montana Economic Development Board financial assistance to offer low interest loans in amounts less than $200,000;

7. Reform Montana's laws regarding liability and tort, workers compensation, securities. Continue the "window of opportunity" on the coal severance tax. Conduct study on comprehensive property tax rate reform.

- enact the statutory changes to workers compensation laws that have been recommended by the Division of Workers Compensation and its advisory committee;
- enact liability and tort reform recommended by the subcommittee of the Governor's Council on Economic Development:
    - limits on punitive damages
    - punitive damages paid to a state fund rather than plaintiff
    - eliminate joint and several liability
    - enforce Rule 11, dealing frivolous lawsuits
    - better define bad faith; modify collateral source rule; encourage structured awards rather than lump-sum awards
- continue the 1/3 "window" reduction in the coal severance tax for the next biennium;
- conduct a comprehensive study of the property tax rates and structure; consider reducing property taxes and provide local governments other options for generating revenue;

8. Prepare for agriculture and each natural resource industry a long range plan that addresses the appropriate level of production, future markets, future supplies, and regulatory or taxation requirements that hinder growth.

- The plans should address:
  - relationship of the industry to the rest of Montana's economy;
  - projected levels of sustainable development - existing and potential markets
  - sustainable resource supplies, both physical and administrative
  - state-of-the art production and processing techniques
  - production and transportation costs
  - state or local regulatory and tax policies that hinder growth

APPENDIX: BACKGROUND DATA

Employment and Income

The total number of jobs in Montana is nearly 400,000. As seen in Table 1 below, the break down of basic jobs in the state -- agriculture employs the most people of the basic industries with 37,000 jobs. Manufacturing provides 24,000 jobs (40 percent of which are wood/paper products), travel/tourism 23,000, transportation/communications/utilities 25,000, mining and oil and gas total 7,000 jobs. The federal government, which is treated as a basic industry because it brings in outside dollars, provides 23,000 Montana jobs.

TABLE 1

	1969		1979		1985	
	Number (000's)	%	Number (000's)	%	Number (000's)	%
TOTAL EMPLOYMENT	296	100	392.5	100	394	100
Basic Industries						
Agriculture	40	14	38	10	37	9
Manufacturing	26	9	29	7	24	6
Mining[1]	4	2	9	2	3.5	1
Oil/gas	2	1	4	1	3.5	1
Logging	-	-	.5	-	.5	-
Transp/Comm/Util[2]	17	6	26	7	25	6
Federal Gov.	23	8	24	6	22	5
Travel/Tourism[4]	13	4	17.5	4	23	5
Non-Basic						
Private Services	49	17	70	18	78	20
Retail	49	17	70	18	78	20
Wholesale	12	4	18	4	20	5
Construction	14	5	23	6	20	5
F.I.R.E.[3]	12	4	22	6	25	6
State/Loc Gov	48	16	52	13	53	12

(1) Mining Components:	1969	1979	1985
Coal	.1	1.3	1.6
Metals	3.3	2.3	.9
Non-metals	.8	1.1	1

(2) Transp/Comm/Util: Transportation, Communications, Public Utilities
(3) F.I.R.E.: Finance, Insurance, Real Estate
(4) Travel/Tourism: Employment levels were derived from data presented by Richard Dailey in The Montana Travel Industry, 1983; .6 of those jobs were subtracted from private services and .4 were subtracted from retail so that BEA totals remain the same.

from: Regional Economic Information System
Bureau of Economic Analysis

The importance of the forest products industry is masked by the table above, because the fact that approximately 40 percent of the manufacturing jobs have been in that industry is not shown. Approximately 10,000 jobs are provided in the wood and paper products manufacturing industry.

The importance of the basic industries is that they bring outside dollars into Montana. Those dollars finance the jobs in the basic industry plus finance additional jobs in the non-basic sectors. On the average in Montana, 1 job in a basic industry generates approximately 2 additional jobs in non-basic sectors. The higher paying basic jobs, such as mining, generates more non-basic jobs than the lower paying basic jobs, such as those in travel/tourism.

The number of jobs in agriculture has declined since 1969. Mining jobs have declined since 1979, and manufacturing increased between 1969 and 1979, then declined since. Those job fluctuations primarily are due to the rise of the wood products industry in the '70's and then its decline during the '80's.

The transportation/communications/utilities sector grew in the '70's and has leveled off in the 1980's. Closing of Burlington Northern and Mountain Bell offices in a number of Montana communities accounted for some of the losses in this sector. The travel and tourism industry has grown steadily, which has helped mitigate the losses in agriculture and the natural resource industries.

A strong increase in the number of jobs in the non-basic sectors of retail/wholesale trade, private services, and finance/insurance and real estate has helped offset losses in Montana's industries. Growth of non-basic industries in the face of decline in our traditional basic industries suggests that internal growth can be stimulated within the non-basic sectors. Growth of travel/tourism may have helped generate some of the non-basic growth.

Sectors that appear to have the most potential to substantially increase Montana's employment are: tourism and manufacturing as basic industries, and private services, retail and wholesale as non-basic sectors.

The natural resource industries do not appear to offer substantial employment growth potential on a statewide basis. However, it is important to remember that these industries are very important to the economies of individual areas and communities within the state.

Table 2 below shows the relative importance of Montana's basic industries in terms of gross income from the sale of products. Agriculture generates 1.7 times as much gross income as the number two industry -- oil and gas.

TABLE 2

	1984		1985	
Agriculture	$ 1.7 billion	30%	$ 1.4 billion	29%
Oil and gas	968 million	18%	841 million	17%
Travel/Tourism	850 mm	15%	791 mm	16%
Lumber/Paper/Wood	675	12%	742 mm	15%
Manufacturing	700 mm	13%	594 mm	12%
Mining	623 mm	12%	544 mm	11%

Source: USDA Agricultural Statistical Reporting Service

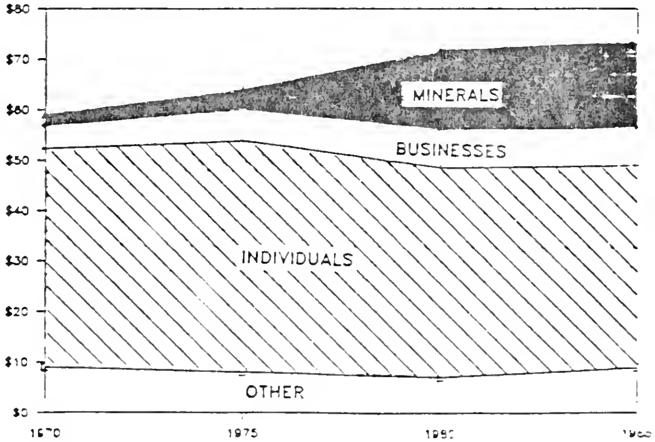
Taxes

Taxes are frequently cited as one of the principal barriers to business growth in Montana. In several surveys (see page 24) taxes emerged as a significantly perceived factor affecting economic growth.

The amount of taxes paid per $1000 income is shown in Figure 1 below. As shown, individuals pay the bulk of Montana taxes as a share of income. However, while the taxes per $1000 income for individuals has declined, the taxes for business has increased, and the taxes on mineral production has increased dramatically.

FIGURE 1

MONTANA TAX REVENUE BY TYPE OF TAX
State Taxes Per $1,000 of Personal Income



Montana Taxes

	Mineral Production Taxes	Business Taxes	Taxes on Individuals	Other Taxes	Total Taxes
1970	$2.20	$4.55	$43.30	$9.26	$59.31
1975	4.00	6.13	45.90	7.85	63.88
1980	15.70	7.60	41.60	7.24	72.14
1985	17.30	7.30	40.00	9.13	73.73

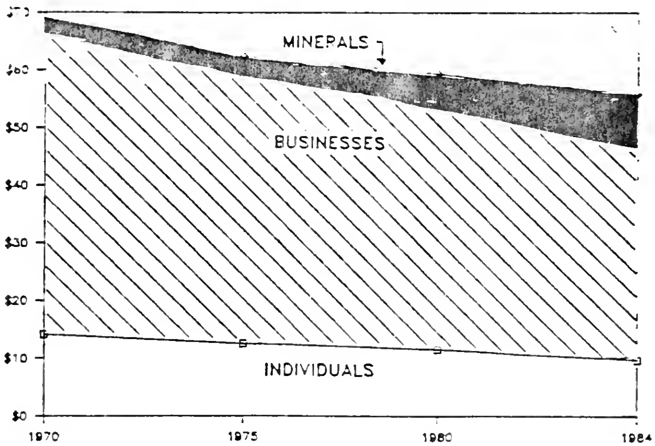
Department of Reve

Property taxes are widely cited as a deterrent to business growth, both because business and industry allegedly pay proportionately higher property taxes, and because property taxes are not related to profitability or ability to pay in any one year.

Figure 2 shows the comparison of property taxes paid by business mining, and individuals (individuals primarily pay on residential and personal property).

Figure 2

MONTANA PROPERTY TAXES BY SOURCE
Per $1,000 of Personal Income

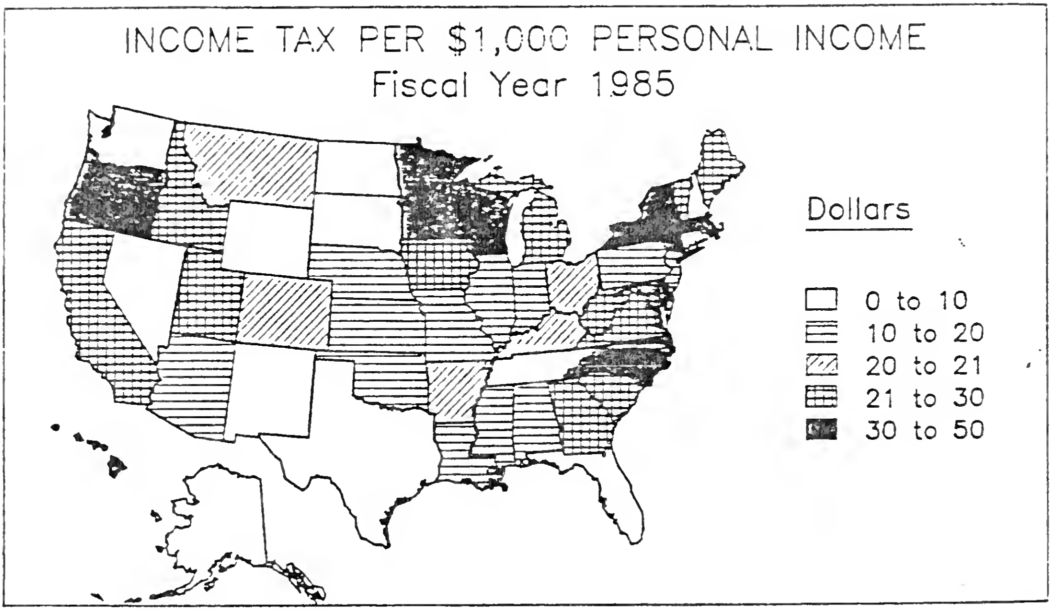


Montana Property Taxes

	Individual Property Tax	Business Property Tax	Mineral Property Tax	Total Taxes
1970	$14.10	$51.90	$3.00	$69.00
1975	12.50	46.10	3.70	62.30
1980	11.50	41.90	5.90	59.30
1984	9.70	36.50	9.60	55.80

Figures 3 and 4 show that both Montana residential property owners and business property owners pay less than the national average in property taxes.

FIGURE 3



Montana's Individual Income Tax is Below Average.

Figure 2 indicates that Montana's individual income tax, our largest source of state tax revenue, is just below the national average of $21.15. Our tax was $20.84 per $1,000 personal income, 23rd lowest.

Delaware imposes the greatest burden with a tax of $43.61. Seven states do not levy an individual income tax (Alaska no longer levies the tax but still is receiving some revenue from back years).

INDIVIDUAL INCOME TAXES

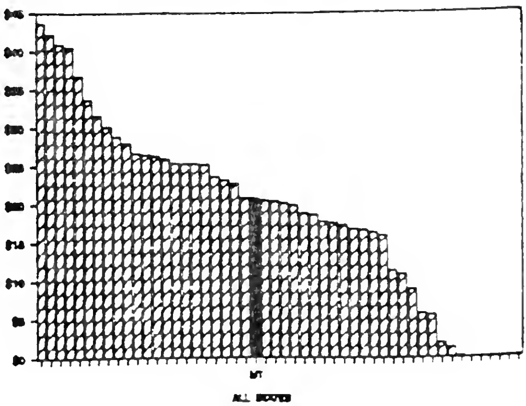
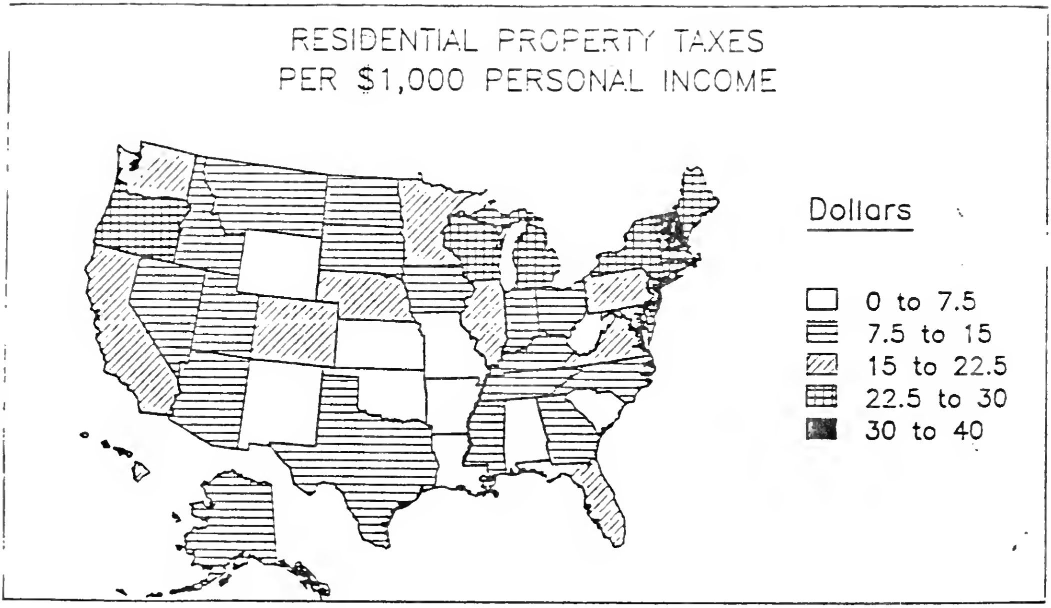
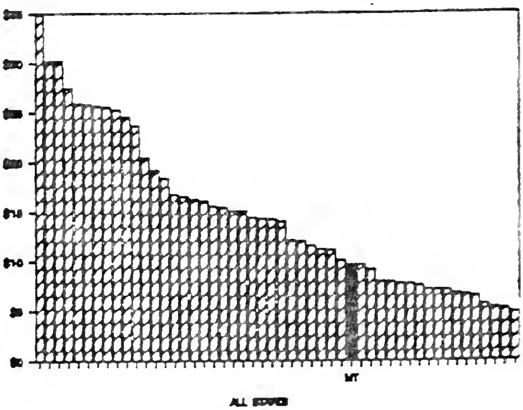


Figure 4



Residential Property Taxes are 43% Less Than National Average.

RESIDENTIAL PROPERTY TAXES



Montana's residential property tax is $9.69 per $1,000 of personal income, or 43% lower than the national average. Our tax ranked 33rd in the nation by this measure.

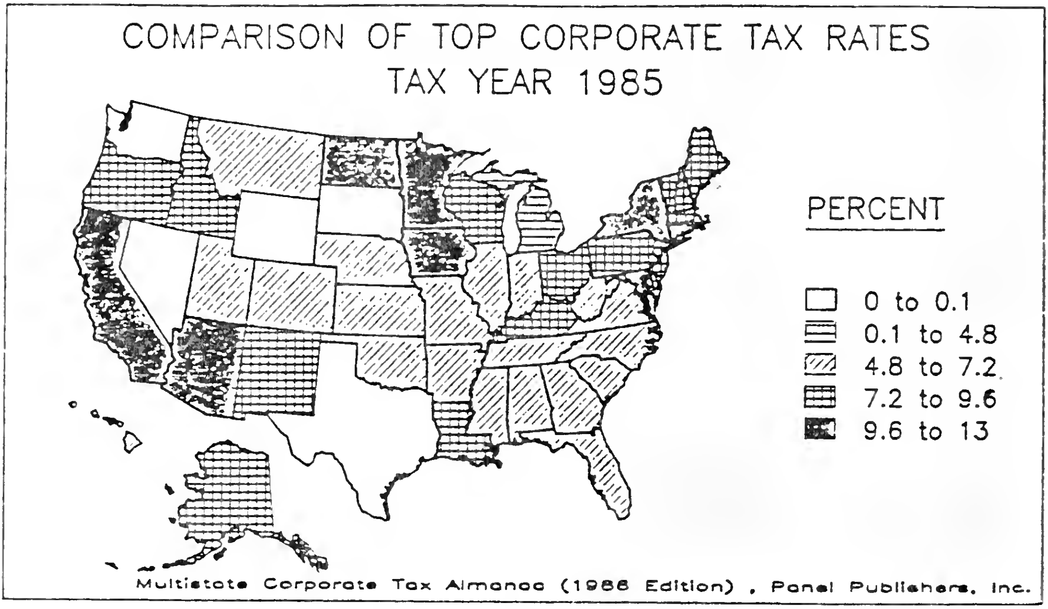
Alabama imposes the lowest residential property tax ($4.83). The highest taxes are imposed by northeastern states.

New Hampshire relies almost exclusively on the property tax for its revenue and this is reflected in its ranking (1st) and its tax burden ($34.87). New Hampshire is followed by New Jersey ($30.24) and Vermont ($30.24).

Department of Revenue

Montana's corporate income tax of 6 3/4 % ranks Montana below the average(7.5%) among the 50 states, (see Figure 5 below).

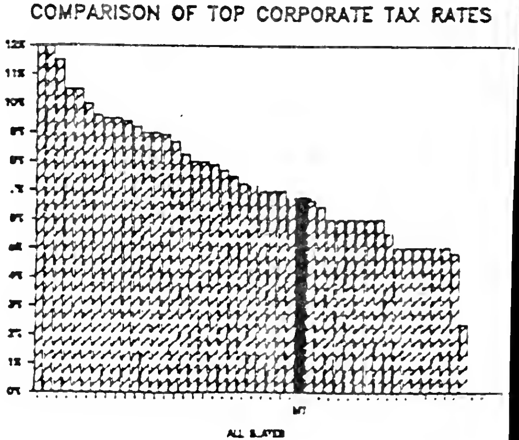
Figure 5



Montana's Corporate Tax Rate is Below the National Average.

Montana's corporate income tax appears reasonable for most "general" businesses. Our tax rate of 6.75%, which has been in effect since 1971, ranks 20th in the nation out of the 45 states imposing the tax. It is less than the average rate (7.5%) imposed by these states.

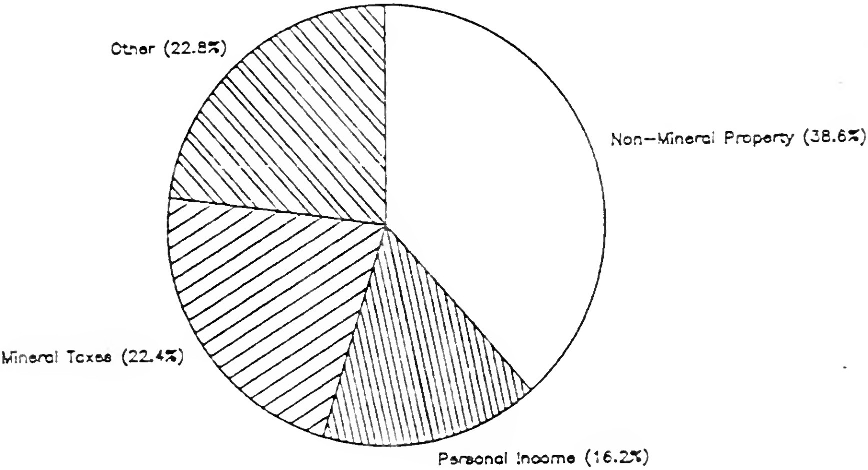
The lowest corporate income tax rate of 5% is imposed by a number of states. The highest rate of 11.5% is levied by Connecticut; followed by the 10.5% imposed by North Dakota and Arizona.



The taxes assessed against the minerals industry can be looked at separately, although taxes paid by the industry go to two levels of government: (1) the state, primarily through severance taxes and (2) local government units, primarily through local property taxes. The total of state and local taxes on minerals places a substantial burden (22.4%) on that industry, as shown in Figure 6 below.

Figure 6

Montana's Mix of Major Taxes



Montana's oil and gas taxes are average for petroleum-producing states (see Table 3 below).

TABLE 3

Average Oil Production Taxes

Fiscal Year 1985

State	Average Tax on Gross Value
Alaska	12.25%
Louisiana	13.45
Wyoming	13.07
Montana	12.15
North Dakota	12.07
Oklahoma	8.04

Department of Revenu

The coal industry bears the primary burden of the minerals tax. The tax burden on coal is very high compared to other states, see Table 4 below.

TABLE 4

Average Coal Production Taxes

Average Tax On Mine Value

State	Property	Severance	Total
Colorado	0.9%	3.9%	4.8%
Montana			
"Base Coal" (30%)	3.0	19.9	22.9
"Window Coal"	3.0	13.6	16.6
New Mexico	0.5	4.5	5.0
North Dakota	0.0	5.1	5.1
Wyoming	5.4	8.4	13.8

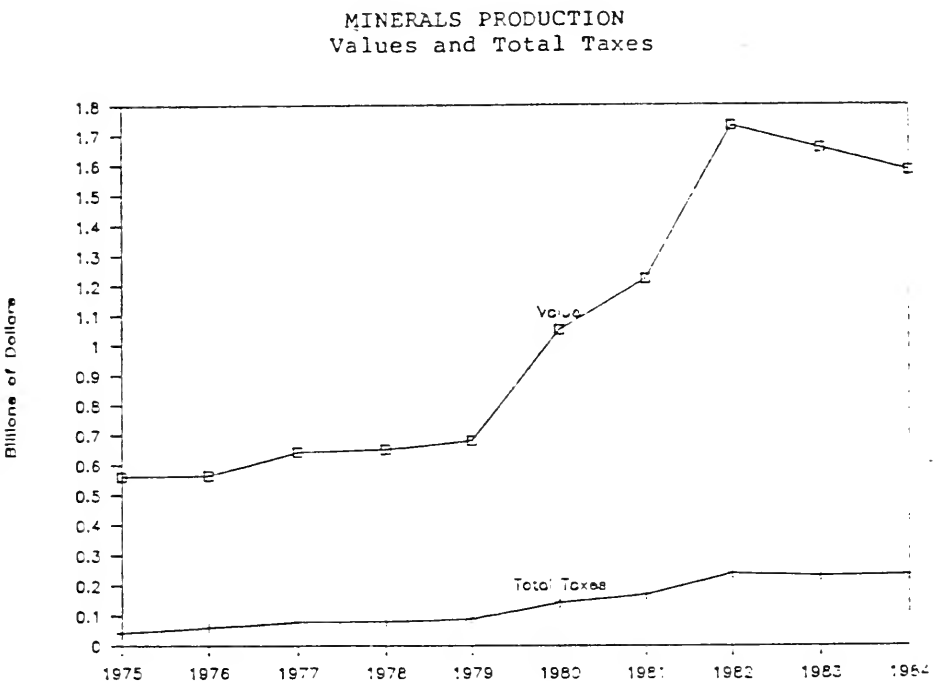
Department of Revenu

Montana's coal taxes have been reduced from the levels shown through a deduction for a portion of the royalties paid to the state, to the federal government, and to Indian Tribes. This deduction will reduce the level of our production taxes on "base" coal from the 22.9% level to 21.6% when it is fully phased-in[6].

The average effective rate is further reduced for new coal sales through the 33.3% "window of opportunity" severance tax credit. The current effective rate for "window coal" is 16.6%. It will also decline to 15.34% as the royalty deduction is fully phased-in.

Montana taxes on minerals have increased since 1975 (see Figure 7). Interestingly, the increase in mineral taxes has not kept up with the dramatic increase in the value of mineral production since 1979.

FIGURE 7



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Taxes on extractive resources are paid mostly by out-of-state consumers. That is a major benefit to Montanans, because the taxes are exported out of state. However, that exportation of taxes may have a negative effect of deterring outside investment in Montana resource development.

Attitudes and Perceptions

Understanding the factors that business and industrial firms consider important in deciding to locate a new plant or to expand an existing plant is vital to any strategy for promoting economic growth.

Less critical, but nonetheless salient, is an understanding of the perceptions, real or not, that outside investors and industrialists have of Montana as a place to do business.

One recent survey of Montana and Western states' business firms was conducted by the Montana Council on Economic Education. That organization's research points to a number of conclusions.

Table 5 shows that non-Montana businesses consider labor availability, labor costs, regulatory policies, property taxes and union strength as the five most important factors influencing a decision to locate in a state. They also considered academic institutions, transportation costs, and corporate income taxes as relatively important.

TABLE 5

Rank Importance of Factors in the Business Climate
Influencing a Firm's Decision to Locate in a State

Factor	Ranking of Factor: Non-Montana Respondents	Ranking of Factor: Montana Respondents
Labor force availability	1	10
Labor costs	2	1
State regulatory policies	3	4
State property taxes	4	2
Union strength	5	3
Academic institutions	6	19
Transportation Costs	6 (tie)	5
State corporate income taxes	6	9
Energy costs	9	8
Location near major markets	10	7
State capital gains taxes	11 (tie)	11
Living costs	11	17
Recreational opportunities	13	16
Licensing requirements	14	14
Availability of state money for business expansions	15	12
Access to raw materials	15 (tie)	6
Climate	15	18
Sales taxes	18	13
Waste/hazardous materials disposal facilities	19	15

However, in contrast Table 6 shows that high technology firms placed little significance on tax climate or regulatory policies. Those firms were more concerned about labor costs, availability of skilled labor, cost of living and transportation.

TABLE 6

Significance of Factors Determining Location or Expansion in a State

Location Factor	No Significance	Some Significance	Significant	Very Significant
	(percentages of all respondents)			
		Location		
State tax climate	52%	21%	16%	11%
State regulatory practices	53	18	19	11
Access to markets	39	14	19	28
Labor costs	33	21	28	18
Labor skill and availability	34	21	25	20
Access to raw materials	57	18	17	8
Cost of living	42	27	23	8
Transportation	42	21	24	13
Energy costs and availability	47	21	22	10
Climate	50	17	22	11
Cultural amenities	58	22	17	4
Academic institutions	56	22	15	8
		Expansion		
Train labor	39%	32%	22%	8%
Offer financial incentives	18	20	34	28
Procure resources from local business	42	29	21	8
Reduce taxes	14	18	29	39
Cut red tape	20	20	26	34
Reduce lost time during inspections	43	28	17	13
Improve community attitude	41	28	17	15
Improve cultural amenities	48	33	14	4
Improve recreational facilities	49	31	15	4

Source: Federal Reserve Bank of Kansas City High-Technology Survey

Tables 7 and 8 show fairly clearly that Montana and western states' businesses felt that taxes and business climate were the two most important factors hindering business growth in Montana.

TABLE 7

Responses to "What change in legislative/regulatory policy would increase the attractiveness of Montana as a location for your business?

Response	Overall	Out of State	Montana
Reduce taxes/offer incentives	26%	22%	29%
Less regulation	8	5	9
Pro business climate	8	8	8
Sales tax	8	3	11
Liberalize workers' compensation	7	4	9
Liability claim limitation	5	1	8
Right-to-work law	5	0	9
No response	45		

TABLE 8

Responses to "What is the single most negative aspect of Montana as location for your business?"

Response	Overall	Out of State	Montana
Tax burden	17%	10%	23%
Anti-business climate	12	4	18
Distance from markets	9	12	8
High transportation costs	9	7	11
State government policies	8	3	11
Climate	7	14	8
Workers' compensation/liability	5	1	8
No response	18	26	12

A survey of Montana associations conducted by a subgroup of our Economic Transition Task Force showed basically the same results.

Conversations with Bill Duffy, the business recruitment specialist with the Department of Commerce, and three local economic development directors in Montana, indicated some perceptions of those businesses that are interested enough in locating in Montana to visit communities. Distance from markets, transportation costs, property taxes and the unitary accounting method were among the most commonly mentioned negative features. All of these men thought Montana suffers from a bad image as a place to do business.

OBSERVATIONS AND CONCLUSIONS

Local Economic Development Programs

Economic growth occurs in local communities. Outside firms interested in relocation select specific communities, not states. A state can make its overall business climate more attractive, which gives all of its communities a better competitive advantage, but the circumstances within a particular community determine whether a firm will locate in Montana.

Butte stands as one example of a Montana community that has worked internally to foster economic growth. It did receive a sizable financial award from ARCO to initiate an economic development program. But it is to the credit of the Butte community that that money and other funds were spent thoughtfully and carefully in order to produce real results.

Even before Montana Resources, Inc. reopened the mines, the private businesses and local government officials worked together to start up and bring new businesses, help existing businesses expand, and revitalize the downtown area. Through urban revitalization alone, Butte created more than 300 permanent jobs.

Missoula has been successful in replacing most of the nearly 1,000 jobs lost in that community by employment reductions in the wood products, railroad, telephone and other basic industries. Missoula's downtown redevelopment program alone has created more than 500 new jobs in the community.

Montana has made great strides toward offering real help to local communities in economic development. More can be done. A high priority for an economic growth strategy must be furthering a strong program at the local level for fostering economic development.

A strong local economic program must include:

-the ability to provide the public facilities and services necessary to accommodate growth;
-the technical and financial ability to prepare the plans and analyses necessary to bring the community into a competitive position;
- availability of capital for private ventures;
- the cooperative, aggressive promotion and work by local government and the private business sector;

Rural Communities

The small and rural communities in Montana usually receive marginal benefit from state efforts to stimulate economic growth unless the state sets out to affirmatively provide help. State

efforts to attract large corporations and investments typically benefit Montana's larger cities.

A state economic growth strategy can help rural areas by directing technical and financial assistance to those communities that committed to improving their economic picture. Assistance with feasibility studies, marketing and market research, and community improvement is valuable for small communities.

With most Montana communities tied to agriculture as the primary economic base, technical assistance should focus on value-added processing of agricultural products, non-agricultural manufacturing and, where appropriate, travel and tourism.

Agriculture

Agriculture provides 9 percent of the state's total jobs, but it provides the greatest number of jobs among the basic industries, and generates the greatest gross income of the basic industries.

Agricultural production offers little opportunity for employment growth. Given the current decline in agricultural jobs, the best that can be hoped for is to try decelerate that decline.

Agriculture is like the natural resource industries in that its problems are national and international in scope. Montana cannot do a lot to improve economic conditions for agriculture.

Although agriculture may not be a key to stimulating significant overall growth in the state, we must give high priority to protecting its economic health. Probably 85-90 percent of the communities in Montana are dependent on agriculture for their economies. Also, agricultural production offers a real opportunity for "value-added" processing that could materially effect economic growth in Montana.

The structure of agriculture is important economically. More than 80 % of the farms and ranches in Montana are family owned and operated. That high percentage of small, family owned operations means that the industry is not dominated by any group of major owners. The fact that thousands of independent farm and ranch owners make their own decisions gives the industry an elasticity that allows the dependent businesses in agricultural communities to survive the difficult times. Unlike the timber and mining industries, where a decision to close by a dominating major corporation might devastate a community, the agriculture industry survives in a community even though one or several individual farming operations may fail.

Also, a family farm or ranch is more likely to "tough out the bad times" and stay in business than a farm operated by an out-of-state corporation that has little compunction about

closing down a money-losing operation.

Montana needs to give a high priority to protecting the vitality of agriculture as an industry. Halting its decline is imperative to any state economic development strategy.

As with the natural resource industries, a state growth strategy should focus on promoting the further processing of agricultural products.

Tourism

Travel/tourism has become one of Montana's most important basic industries. It is one of the basic industries that holds promise for significant expansion.

Although many of its jobs are lower paying, or are seasonal or part-time, the industry provides the third highest number of jobs and the third highest gross income among the basic sectors.

Mining, Logging, Oil and Gas

Montana's natural resource production industries -- mining, logging, oil and gas development -- constitute only 3 percent of the total employment in the state (although they are high paying jobs). Even accounting for their multiplier effect, these production industries do not represent opportunities for appreciably adding to Montana's overall employment growth, although they are vital to the economies of a number of Montana communities and trade areas.

Also, most factors influencing the economic health of natural resource industries are beyond Montana's control: national and foreign markets, prices and policies.

With the apparent exception of the coal severance tax, Montana's regulatory and taxation policies probably are not deterring growth in these industries. The state's taxation and regulatory provisions governing these industries are in place after long, often bitter, but always open, public debate. The regulations governing natural resource development have been adopted, and challenged, in open public debate, to achieve some public interest objective. Much of Montana's civil warfare cited by David Birch centers on these industries.

Given (1) the small percentage of jobs provided by the natural resource industries, (2) the apparent insignificant effect of regulations and taxation, and (3) the political warfare that likely will accompany proposals to significantly alter current taxes or regulations, an economic growth strategy for Montana should focus on providing positive help to the industries rather than changing regulatory and taxation policies. That positive assistance can take such forms as helping prepare long

range natural resource plans, settling the roadless lands issue, identifying long term timber, and other resource, supplies.

However, the tax structure and regulations governing the natural resource industries should be honestly reassessed to eliminate or change provisions that do not achieve an important public objective and that stifle growth. Such a re-assessment should be conducted in the interest of fairness and the local economies that might be affected, rather than as part of a statewide stimulation of economic growth.

The real opportunity presented by the natural resource industries is in further processing of the raw materials produced. Already a large part of Montana's manufacturing industry comprises wood/paper products. Much more processing of minerals and wood products is possible in this state.

Unitary Tax Accounting Method

Montana assesses corporate income taxes on national and multi-national corporations based on the percent of corporation's total income derived in Montana. The unitary tax accounting system prevents the practice by major corporations of avoiding Montana taxes by shifting Montana-derived income to states with lower taxes.

Without the unitary accounting method, major corporations would be able to shift Montana-derived income and thereby escape paying the same amount of taxes as Montana businesses.

Montana businesses would be hurt both by the increased competitiveness of major corporations, and by the likely increase in the corporate tax rate needed to offset the loss of revenue.

The Department of Revenue estimates that changing the unitary tax accounting system would mean the loss of revenue of $4-10 million.

While Montana is one of a few states that uses a "world-wide" system of corporate taxation (a firm must report its income from all locations in the world), the state, as a matter of current practice, does not apply the unitary method for foreign-based parent companies. Therefore Japanese and other foreign-based companies are not affected by the state's unitary taxation system.

There are at least four options for changing Montana's unitary tax system. First, the system could be eliminated for all national and multi-national firms. Second, the system could be applied on to the "water's edge," which would use the system for U.S operations of major companies. Third, the current policy of not applying the system to foreign-based corporations could be enacted into state law. Fourth, the state could adopt a approach similar to that of California, where the integrity of the

accounting system was maintained but the stigma of "unitary" was removed.

If the unitary system is modified, it should be done in a way that does not penalize small, or Montana businesses. New or expanded Montana businesses will the long term source of economic growth, and they should not suffer in our attempts to lure major corporations.

Most people in Montana agree that the negative perception of the term "unitary" is worse than its actual effect, as applied in Montana. Whatever is done with the system, a vigorous public relations campaign is necessary to overcome the stigma.

Effect of Taxes on Economic Growth

Overall, Montana's effective tax rates on business and industry are average or below average, and should not present a deterrent to economic growth. The apparent exception is the coal severance tax, which is significantly higher than any other state, and even with Montana's advantages in transportation costs, may make Montana uncompetitive with Wyoming.

The unitary tax accounting system used by Montana to tax income of national and international corporations does not appear to be greatly out of line with other states, and has the element of treating Montana and out-of-state businesses equitably. However, the mere term apparently deters major corporations from even considering Montana as a place to locate or invest.

Property taxes have raised considerable concern among Montana businesses and prospective firms. Local governments also criticize the fact that their operations are so dependent on property taxes.

The state needs to undertake a comprehensive study of the property taxation structure in Montana, looking at completely revising the rates and levels of property taxes. Assuming that property tax relief would be recommended by such a study, other revenue options for financing local government must be made available.

Even in the absence of a comprehensive study, additional local tax options would benefit local governments and help spur economic development. Those options could include a local sales tax, a local income tax (assessing a percent of state income tax), an accommodations tax.

Branch Banking; Interstate Banking

Considerable support exists in Montana for changing Montana banking laws to allow branch banking, bank merger and consolidation, and interstate banking. Those advocates argue that Montana would have better availability to the national and international flow of capital under interstate banking.

A legitimate concern seems to be that interstate banks would become prominent financial institutions in the state, and would tend to export capital in the form of Montana savings deposits, rather than import dollars to the state. This concern seems particularly valid in light of the fact that Montana investments usually are relatively small, with low opportunities for sizable return on the invested dollar. A New York based interstate bank is more likely to use Montana deposits to invest in a "hot" Seattle market, than invest out-of-state dollars in a Montana venture.

Another concern is that an interstate bank would not be interested in investing in agricultural loans, small business loans, or loans to agricultural-related processing projects in Montana.

Giving credence to such concerns is the fact that in fiscal year 1986, the top seven banks providing the highest amount of Small Business Administration guaranteed loans to small businesses in the state were Montana independent banks.

Not only will large banks be unlikely to invest in Montana small business or agriculture, Montana would benefit more by investment of in-state capital in many small new enterprises where more of the profits from those enterprises stay in the state to circulate and generate secondary benefits.

Sales Tax

The advocates of a sales tax talk about a "balanced" tax structure. The result of replacing a portion of local property taxes with a sales tax would be to shift the overall tax burden, most likely away from business and industry and to homeowners, consumers, and lower income families.

The concern here is not only in regard to the social ramifications, but the fact that under the new federal tax law, sales taxes are not deductible while property taxes will be allowed deductions. At least an honest study of the implications of replacing federally deductible property taxes with a non-deductible sales tax seems a prudent step before imposing a statewide sales tax.

Enactment of a sales tax as one of several local options is recommended. Some communities may have economic circumstances

(such as a high percentage of travelers or out-of-town sales) that would make a sales tax desirable.

Giving individual communities the option to adopt a sales tax could create one problem. Those communities that opted for a sales tax might suffer because shoppers, travelers and businesses would avoid buying or locating in those communities.

Attitudes and Perceptions

Probably one of the most significant forces for portraying Montana as a place to do business are the existing businesses. Montana's image is perhaps more damaged by Wall Street Journal articles describing a major employer that is consistently protesting its property taxes, or by an uncooperative company loudly criticizing long standing requirements.

Existing industry and business perhaps can do more to improve Montana's business image than anyone. Our most effective (or most damaging) advertising is our own business community.

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